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No. 56

In the Supreme Court of the United States

OCTOBER TERM, 1939

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

THE F. & R. LAZARUS & COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE PETITIONER

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OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 16–24) is reported in 32 B. T. A. 633. The opinion of the Circuit Court of Appeals (R. 127–133) is reported in 101 F. (2d) 728.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 16, 1939 (R. 127). The petition for a writ of certiorari was filed May 16, 1939, and granted October 9, 1939. The jurisdiction of this Court rests upon Section 240 (a) of

the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer conveyed certain real property, and made an assignment of long-term leases on other property, receiving in return, in addition to a cash consideration, a 99-year lease upon the premises conveyed, with options of renewal and purchase. Should this transaction be treated as a mortgage to secure a loan or as a sale in determining whether the taxpayer is entitled to deductions for depreciation on the buildings occupied by it under the 99-year lease?

STATUTE INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * * *
>
> (k) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the

trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in section 113 for the purpose of determining the gain or loss upon the sale or other disposition of such property.

* * * * *

STATEMENT.

The pertinent facts, as found by the Board of ax Appeals (R. 17-21), and as summarized by the ircuit Court of Appeals (R. 127-130), are as llows:

The taxpayer, an Ohio corporation organized in 51, operates a department store in Columbus, Ohio . 17, 128). In 1928 it was conducting its busiss in three buildings which it had previously con-

structed at an aggregate cost of $2,467,952.57. Two of the buildings were erected on ground then owned by the taxpayer in fee, and the third building, erected in 1921 at a cost of $258,054.71, was constructed on ground held by the taxpayer under a 99-year lease with option to purchase, acquired in 1915. It also held another parcel of ground under a 99-year lease with option to purchase (R. 17, 128).

In 1928 the taxpayer had a mortgage of $1,700,000 outstanding on the property it owned in fee and owed slightly more than $1,500,000 on short-term notes, and it sought means of spreading the obligations over a longer period of time. The only avenue open to it was through the equities it had in its real property (R. 18, 128). A banking house in Chicago, the holder of taxpayer's short-term notes, suggested a loan of $3,750,000 for 25 years at 5 percent interest, secured by a mortgage on taxpayer's real property, conditional upon the purchase of the notes at 97.25 and the creation of a sinking fund, which, with interest on the loan and trustee expenses, would have involved an outlay of $210,000 per year (R. 18–19, 128). The Huntington National Bank of Columbus, one of taxpayer's bankers, suggested a loan of $3,500,000 at 5 percent, based upon the issuance of land-trust certificates. This proposal was accepted by the taxpayer, but was limited to $3,250,000 in amount (R. 19, 128).

The transaction was closed in this manner: The taxpayer executed and delivered to the Hunting-

ton National Bank, trustee, a deed to the property it held in fee and assignments of the 99-year leases it held for the remaining property, and concurrently the trustee leased the property to the taxpayer for a term of 99 years, with options of renewal for like terms and of purchase at specified prices (R. 19, 128). At the same time the Bank executed a declaration of trust stating that it held the property for the use and benefit of all present and future holders of the land trust certificates (R. 19, 129). The sum of $3,159,687.50 ($3,250,000 less discount of 3.25 percent) was received by the taxpayer from the Bank under the transaction. This sum was used by the taxpayer to take up its mortgage on the property and short-term notes. (R. 19, 128). The release of the mortgage, the deed to the trustee, and the declaration of trust were recorded consecutively on June 28, 1928 (R. 19).

The lease from the trustee to the taxpayer states that the Bank is trustee for those who might be or become the owners of land trust certificates and provides for annual rentals during the term of the lease based upon an annual return of 5 per centum on $3,250,000 (R. 19; Ex. 6, pp. 51, 54–55). It also provides, among other things, that the lessee shall create a depreciation fund and make quarterly payments to the trustee for deposit until the fund reaches the sum of $2,600,000, and that such obligation may be satisfied by the delivery of cash, land trust certificates issued under the declaration of

trust, or obligations of the United States; that the lessor shall pay interest on the amounts deposited in such fund, provided that any amounts may be, at the request of the taxpayer, invested in obligations of the United States or certificates issued by the trustee under its declaration of trust; that the lessee shall have the option to purchase the lessor's interest in the property for $3,605,000 between June 1, 1933, and May 31, 1938; for $3,570,000 between June 1, 1938, and May 1, 1948; for $3,535,000 after June 1, 1948, plus, in each case, accrued rentals to the date of purchase; that in case the option to purchase is exercised there shall be credited on the purchase price (1) all amounts then in the hands of the lessor as trustee not otherwise due for distribution under the terms of the trust agreement with the certificate holders, (2) any amounts in the hands of the lessor received as compensation for the appropriation to public use of any part of the premises, (3) the amount of cash in the depreciation fund, including the net proceeds of any securities other than land trust certificates, and the option price of any land trust certificates held in the depreciation fund, and (4) the net unappropriated proceeds of any insurance; that the lessee shall pay all taxes and other charges on the depreciation fund; that in case the lessee fails to exercise the option to purchase or the lease is terminated on account of default of the lessee, the depreciation fund shall become the prop-

erty of the lessor as liquidated damages for depreciation in value of the premises; that in case of condemnation of a substantial portion of the premises the lessee shall exercise the option given it to purchase; that there shall be no diminution of rent in case of condemnation or loss by fire of any portion of the premises; and that the lessee shall pay all taxes and insurance on the property and keep it in good condition, order, and repair (R. 19–20, 129–130; Ex. 6, pp. 51–94).

The lessee, while not in default, and upon giving proper security, may remove and replace the buildings by paying all costs of the new buildings which are to become a part of the realty (Ex. 6, pp. 72–78, 82–83). In case of default the lessor has the right to declare the term of the lease ended, to reenter the premises, buildings, and improvements, and "again to repossess and enjoy as of the Lessor's first and former estate, free of any right or claim on the part of the Lessee," and the lessee is to "surrender said premises, together with the buildings, improvements, and fixtures then thereon" (Ex. 6, p. 83). The lessor has a first lien on the leasehold estate for amounts due under the lease (Ex. 6, p. 85).

The land trust certificates were sold by the Bank to the public at $1,010, to yield a return of 4.95 per centum (R. 20, 128–129). Each certificate recites, among other things, that the holder is the owner of a fraction, stated in 3500ths, "of the equitable ownership and beneficial interest" in the real property

under lease to the taxpayer; that the trustee will account to the registered owner of the certificate for the owner's proportionate share of the trust estate or the net proceeds; and that the certificate is subject to all of the terms of the declaration of trust under which it was issued (R. 20; Ex. 7, pp. 99–103).

The declaration of trust executed by the trustee, in addition to the terms of the certificates as set forth in the preceding paragraph, recites the provisions of the lease to the taxpayer, and provides that the certificates are subject to call at prices varying from $1,010 to $1,030, depending upon the period during which the right is exercised, plus an adjustment for accrued rentals; and that as the property is sold, a distribution of the net proceeds shall be made among the holders of the certificates (R. 20, 129; Ex. 7). The agreement also provides that no beneficiary as such shall have any legal title to the trust property, his interest being equitable only, and shall have no right to call for partition of the trust estate during the continuance of the trust; and that the duties of the trustee shall be restricted to the collection of rent from the trust estate and the distribution of the net proceeds to the certificate holders (R. 20; Ex. 7, pp. 111–113).

The transaction was carried out by the issuance of the land trust certificates rather than by a mortgage loan because local taxation of mortgage bonds made them unmarketable (R. 21, 128; 33–34; 36; 37). A ruling of the Attorney General of Ohio as to what securities were nontaxable similarly ac-

counts for the limitation of the depreciation fund, provided in the lease, to a total of $2,600,000 (R. 21, 130; 34; 38).

The taxpayer at the time of this transaction considered that the property conveyed was worth about $6,000,000 and would not have sold it for $3,250,000 (R. 20, 130; 35). The rent paid by the taxpayer under the lease, however, was less than a fair rental, and the petitioner recognized this by making a rent charge of $375,000 each year in its books (R. 21, 130; 31; 35).

In its returns for the taxable years here involved, the taxpayer claimed deductions from gross income for depreciation on the buildings occupied by it under the lease, based upon a useful life of 40 years (R. 6). The Commissioner disallowed the claimed deductions on the ground that the taxpayer no longer owned the property but was a lessee (R. 9). The Board of Tax Appeals concluded that the deed given by the taxpayer was "in reality a mortgage" and that the transaction was not one in which the taxpayer lost its right to deductions for exhaustion of the property conveyed (R. 21). The decision of the Board was affirmed by the Circuit Court of Appeals (R. 130).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred in holding—

1. That, under the facts herein, the taxpayer in 1928 in reality accomplished a mortgage of its real property to secure a loan and not a sale thereof.

2. That the taxpayer did not effect a sale of its property in the year 1928, and that no absolute conveyance to the trustee was intended.

3. That the transaction in 1928 was not one in which the taxpayer lost its right to deductions for exhaustion of the property conveyed.

4. That the taxpayer-corporation was entitled to deductions for depreciation in each of the taxable fiscal years ending January 31, 1930 and 1931, on property to which it had previously had title but which it occupied during the taxable years in question as lessee under the 99-year leases.

5. That the decision of the Board of Tax Appeals should be affirmed, and in failing to order that judgment be entered for the Commissioner of Internal Revenue.

SUMMARY OF ARGUMENT

The transaction in question provided in terms for an outright sale of the property in consideration for cash and a long-term lease, renewable forever. No debt arose as a result of the transaction, and, accordingly, there is no basis for construing the conveyance as a mortgage. The certificates issued to the public in connection with the transaction are a well-known type of investment and are not in any sense mortgage bonds, notes, or other evidences of indebtedness. On the contrary, the certificate holders have interests in the land itself which are inconsistent with a mortgage relationship between the parties.

The evidence introduced by the taxpayer does not support the conclusion that the terms of the transaction should be disregarded and the conveyance construed in equity to be a mortgage. In any event, the certificate holders may not be prejudiced by any undisclosed understanding between the other parties to the transaction. Accordingly, the taxpayer cannot exercise the rights of a mortgagor and should in this controversy be regarded merely as a lessee.

The taxpayer as lessee has no investment in the property which would support an allowance for depreciation. *Weiss* v. *Wiener*, 279 U. S. 333; *New York Central Railroad Co.* v. *Commissioner*, 79 F. (2d) 247 (C. C. A. 2d), certiorari denied, 296 U. S. 653; *Atlantic Coast Line R. Co.* v. *Commissioner*, 81 F. (2d) 309 (C. C. A. 4th), certiorari denied, 298 U. S. 656.

ARGUMENT

I

THE TRANSACTION EFFECTED A SALE OF THE PROPERTY

The transaction involved in the present case purported on its face to transfer the legal title of the property to the trustee and the equitable ownership to the holders of the land trust certificates in consideration for the transfer to the taxpayer of the sum of $3,159,687.50 and the rights given under the long-term lease. The Board of Tax Appeals concluded from a consideration of all the evidence

that the transaction did not result in a sale of the property and that the deed of absolute conveyance "was in reality a mortgage" (R. 21). In its brief in opposition in this Court (Br. 5–6), the taxpayer contended that the Board thus made a finding of fact which was conclusive if supported by substantial evidence. But clearly the conclusion reached by the Board is not a finding of an evidentiary fact. It is an ultimate finding which involves a "conclusion of law or at least a determination of a mixed question of law and fact." It is subject to judicial review and, on such review, the court may substitute its judgment for that of the Board. *Helvering* v. *Tex-Penn Co.*, 300 U. S. 481, 491; *Bogardus* v. *Commissioner*, 302 U. S. 34, 39; *Helvering* v. *Rankin*, 295 U. S. 123, 131. The considerations properly applicable in determining the effect of the transaction here involved show that the conveyance was not a mortgage and that the taxpayer undertook no obligation for the return of the money it received.

1. The transaction in terms effected a sale and not a mortgage

Under the terms of the instruments evidencing the rights and obligations of the parties to the transaction here involved the taxpayer neither extended an existing indebtedness nor incurred a new one. There is no provision in any of the instruments which obligates the taxpayer absolutely to

repay the sum of $3,159,687.50 received by it through the sale of the land trust certificates. The certificates in question, unlike bonds or notes, are not evidences of indebtedness: they bear no maturity date; they are not in any stated amount; they contain no promise to pay. On the contrary, each certificate states on its face that the holder is the owner of a specified fraction "of the equitable ownership and beneficial interest" in the property covered by the lease (R. 20; Ex. 7, p. 100). While the lease gives it an option to repurchase the property after five years, the taxpayer is not obligated to do so. If the taxpayer chooses, it may renew the lease and continue as lessee forever (R. 92–93).[1] If its interests suggest a different course it may allow the lease to expire at the end of the first 99-year term. In either event the certificate holders cannot force the taxpayer to repurchase the property and retire the certificates. They will continue to be investors in the property held for their benefit by the trustee.

The option here given to the taxpayer to choose whether or not it will repay the certificate holders takes this case outside the typical security transaction evidenced by a mortgage. "To constitute a mortgage, there must necessarily be a debt which

[1] The option to purchase apparently must be exercised prior to the expiration of the first 99-year term (R. 59, 93). It is optional with the taxpayer to refrain from purchasing except in the unlikely contingency that a substantial portion of the premises is taken by condemnation (R. 61).

is the subject of the security."[2] In this connection the term "debt" refers to a subsisting obligation to pay, enforceable by an action in favor of the mortgagee.[3] The courts which have considered the question hold that such a subsisting, enforceable obligation is an indispensable attribute of a mortgage. See *Conway* v. *Alexander,* 7 Cranch 218, 236; *Horbach* v. *Hill,* 112 U. S. 144, 148; *Wallace* v. *Johnstone,* 129 U. S. 58, 64; *Slutz & Larue* v. *Desenberg,* 28 Ohio St. 371; *Gibson* v. *Kraay,* 3 Ohio L. R. 671, affirming, 2 Ohio N. P. (n. s.) 537.[4] In this case an obligation to pay the certificate holders will arise only after the taxpayer has exercised its option to repurchase the property. The existence of such an option clearly does not create a subsisting enforceable debt.[5] It is in no way inconsistent with an outright conveyance: *Wallace* v. *Johnstone,* 129 U. S. 58, 64. On the contrary, such an option has been included in innumerable conveyances which have not been regarded as mortgages. See *Slutz & Larue* v. *Desenberg,* 28 Ohio St.

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[2] 1 Jones on Mortgages (7th Ed.), § 70. See 4 Kent Comm. 153.

[3] 1 Jones on Mortgages (7th ed.), §§ 265, 267, and cases cited.

[4] See *Arizona Copper Estate* v. *Watts,* 237 Fed. 585 (C. C. A. 9th); *Stollenwerck* v. *Marks & Gayle,* 188 Ala. 587. See also Jones on Mortgages (7th ed.), §§ 265, 267, and cases cited.

[5] See *Smith, Administrator* v. *Loewenstein,* 50 Ohio St. 346, 356; *In re Grand Union Co.,* 219 Fed. 353, 356 (C. C. A. 2d); *Embola* v. *Tuppela,* 127 Wash. 285.

371; *Gibson* v. *Kraay*, 3 Ohio L. R. 671; *American National Bank* v. *Groft*, 56 S. D. 460; *Lomond Co.* v. *McNabb*, 109 W. Va. 142, 153.[6] Since the taxpayer is not under an unconditional obligation to pay the certificate holders here, the principles generally accepted in the decisions compel a holding that the transaction here did not in terms create a mortgage on the premises.

Land trust certificates of the kind issued in connection with the transaction involved in the present case have received considerable favor, especially in Ohio, as a new type of investment.[7] The nature of the interests created by such a transaction, accordingly, has been litigated before the courts on several occasions. These decisions establish the existence of rights in the holders of the certificates which are incompatible with the existence of the rights asserted by the taxpayer here. For purposes of inheritance, a certificate is regarded in Ohio as an undivided equitable interest in real estate so as to make the primary quality ownership as distinguished from a security merely incident to a debt *First National Bank* v. *Rawson*, 56 Ohio

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[6] See *Conway* v. *Alexander*, 7 Cranch 218; *Horbach* v. *H* , 112 U. S. 144. See also cases cited in Jones on Mort- ges (7th ed.) §§ 268, 270.

[7] See Goldman and Abbott, Land Trust Certificates with Relation to Ohio Law (1928), 2 Cinn. L. Rev. 255; XI Ohio Bar (May 23, 1938), p. 125; Ohio Gen. Code (Throckmorton, 1926), § 710-140 (d).

App. 388.* The Ohio courts have likewise held that a land trust certificate is not taxable as personal property (*Gibson* v. *Kraay*, 3 Ohio L. R. 671), and a similar decision was rendered in 1926 by the Attorney General. Ops. of the Atty. Gen. (Ohio, 1926) No. 3640, p. 375. These latter rulings are significant in view of the statutory provision imposing a personal property tax on "money loaned on pledge or mortgage of real estate, although a deed or other instrument may have been given for it, if between the parties thereto it is considered as security merely." Ohio Gen. Code (Throckmorton, 1926) § 5325. Since the substance rather than the form of the transaction was the basis of taxation, the trust certificates could have been held nontaxable only upon the ground that the lessee did not have the rights and obligations of a mortgagor. These rulings of the Attorney General and the courts of Ohio are also supported by the considered judgments of the courts of several other jurisdictions. In all of them the land trust certificates were treated as equitable interests in land and not as securities issued in a mortgage transaction. *Nitkey* v. *Ward*, 199 Minn. 334; *Narragansett Mut.*

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* An equitable interest in land has many of the incidents of legal title. See *Lessee of Avery* v. *Dufrees*, 9 Ohio 145; *Biggs* v. *Bickel*, 12 Ohio St. 49; *Bolton* v. *Bank*, 50 Ohio St. 290; *Bank* v. *Logue, Trustee*, 89 Ohio St. 288. The certificate appears to be a device for splitting up the interest in land known as the "ground rent." See *Smith, Administrator* v. *Loewenstein*, 50 Ohio St. 346; *McCammon* v. *Cooper*, 69 Ohio St. 366.

Fire Ins. Co. v. *Burnham,* 51 R. I. 371; *National Department Stores* v. *Board of Equalization,* 111 W. Va. 203; *City National Bank Bldg. Co.* v. *Helvering,* 98 F. (2d) 216 (App. D. C.).

Moreover, the decision of this Court in *Senior* v. *Braden,* 295 U. S. 422, clearly establishes that a transaction in which land trust certificates are issued does not in terms create a security relationship between the parties. The record in that case shows that the provisions in some of the leases and trusts were in all substantial respects the same as the provisions in the instruments evidencing the transaction involved here. Yet the majority of the Court was clearly of the opinion that the transaction there constituted a sale and not a loan or mortgage. There was no mention in the majority opinion of *Kirtland* v. *Hotchkiss,* 100 U. S. 491, and no indication that the Court intended to overrule the doctrine it established that a state may tax a resident creditor on a debt secured by a mortgage on land in another state. In short, the decision stands for the proposition that the purchaser of a certificate acquires an outright interest in the land itself and not a security interest incident to a loan of money.

The opinion of the minority in no way conflicts with the position asserted by the Commissioner in this case. Quite the contrary. The analysis of the incidents of ownership of a certificate holder set forth in the minority opinion clearly differentiates

the certificates from mortgage bonds. If the minority had regarded the transaction as creating a mortgage, it could have rested its opinion solely upon *Kirtland* v. *Hotchkiss*, 100 U. S. 491. Thus it must be regarded as settled that the transaction involved in the present case in terms effected a sale of the property to the trustee for the benefit of the certificate holders.

2. The transaction should be construed according to its terms

The immediate parties to the instruments evidencing this transaction were well aware that the rights and obligations for which they bargained were not the same as those arising from a transaction of a loan secured by mortgage. The testimony of three of the witnesses for the taxpayer establishes beyond doubt that the form adopted was consciously chosen because mortgage bonds were subject to taxation and hence were unmarketable (R. 33–34; 36; 37). Two years before the instruments were executed the Attorney General of Ohio had ruled that a land trust certificate need not be listed by the holder for personal property taxation because "it is not in any sense a mortgage, a leasehold bond or note, but is an evidence of actual ownership in whatever property may be trusteed as a basis for the issuance of any particular series or designation of certificates. The certificate is merely an evidence of the holder's simple individual share

in the ownership of large parcels of property."[9] There can be no doubt from the evidence that the taxpayer and the trustee consciously sought to bring the transaction here involved within the terms of that ruling (R. 34; 37, 38). The trustee would not have entered the transaction had an issue of mortgage bonds been contemplated (R. 37).

Despite such unequivocal evidence the Board of Tax Appeals concluded that "the deed given was in reality a mortgage." The testimony upon which the Board relied does not support such a conclusion. The treasurer of the taxpayer testified that it "would not have sold those properties to the bank or anyone else at that time for approximately three and a quarter million dollars" (R. 35). The representative of the Bank testified: "In closing the land trust certificate transaction I did not consider the Huntington National Bank was purchasing the properties from petitioner; I considered we were doing a financing job for The F. and R. Lazarus Company financing" (R. 38).[10] The credibility of this testimony may be conceded without in any way detracting from the contention of the Commissioner that this transaction did not create a mortgage.[11]

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[9] Ops. of the Atty. Gen. (Ohio, 1926) No. 3640, p. 375, at 376; see also *id.* No. 3869, p. 528.

[10] The Board also relied upon testimony that the Bank required the value of the property to be greater than the amount of money transferred to the taxpayer (R. 38).

[11] This testimony should also be evaluated in the light of certain resolutions of the stockholders and directors of the taxpayer indicating that, at the time, it considered that it

The consideration for this sale was not limited to cash slightly in excess of three million dollars. In addition, the taxpayer as lessee received the right to occupy the premises at a rental which the record indicates is much below the fair value, and the right to repurchase the property at its option (R. 21, 130; 31; 35). There is no basis here arising from inadequacy of consideration for overturning the very carefully chosen terms of the bargain and finding an absolute promise by the taxpayer to redeem when such a promise was not inserted in terms and not desired by either the trustee or the certificate holders. See *Conway* v. *Alexander*, 7 Cranch 218, 236; *Wallace* v. *Johnstone*, 129 U. S. 58, 64. The Bank naturally did not intend to purchase the property for its own account. That is far different from a conclusion that the certificate holders did not purchase the property but merely advanced money as a loan to be secured by a mortgage. The taxpayer and the trustee both contemplated that the money would be raised through the sale of these certificates to the public. They consciously adopted a form which at the time and place was recognized by the investing public as having incidents quite distinct from a security

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was selling, not mortgaging, its property: On June 27, 1928, the stockholders consented "to the sale of the real estate above mentioned" (R. 120). On the same day, the Board of Directors authorized the president and secretary "to sell" the property (R. 121); and at a special meeting the following day the transaction was described as a "sale of the Lazarus properties" (R. 123).

transaction. In view of these facts, the equivocal testimony introduced by the taxpayer cannot be considered sufficient to support the ultimate conclusion of the Board ignoring the terms of the documents evidencing the transaction.

The cases cited by the Board of Tax Appeals (R. 18) for the proposition that a deed, absolute in form, will be treated by a court of equity as a mortgage if it is executed as security for a loan do not support its conclusion in the present situation. The evidence introduced by the taxpayer here does not approach the clearness and certainty required by the decisions either of this Court or the courts of Ohio. See *Campbell* v. *Northwest Eckington Co.*, 229 U. S. 561, 584; *Wallace* v. *Johnstone*, 129 U. S. 58, 64; *Slutz & Larue* v. *Desenberg*, 28 Ohio St. 371.

3. The rights of the certificate holders are inconsistent with the construction of the transaction as creating a mortgage

The intention of the taxpayer and the trustee, even if it was to create a mortgage as security for a loan, cannot be considered as determinative of the rights of the holders of the land trust certificates. The transaction on its face purported to be a sale of the property to the trustee for the benefit of the certificate holders. None of the holders was informed of the existence of a tacit understanding on the part of the taxpayer and the trustee, if there was any, to treat the transaction as a loan

secured by a mortgage. On the contrary, the prospectus informed them that "in the opinion of counsel these certificates represent interests in real property located in Ohio, the taxes on which are paid by the lessee, and therefore are not required to be listed in any State for Personal Property Tax" (R. 38; Ex. 8, facing p. 118).[12]

The cases cited in the Board of Tax Appeals (R. 18) and in the brief in opposition (Br. 5) present the simple situation of a transaction involving two parties both of whom intend that the conveyance in question should be security for a debt. Clearly they do not touch a situation where, as here, the parties advancing the money never regarded it as a loan and were never given notice that the grantor so regarded it. It has been established that the intention of the parties to treat an outright conveyance as a mortgage must be *mutual*. *West* v. *Hendrix*, 28 Ala. 226, 234–235; *Nitkey* v. *Ward*, 199 Minn. 334.[13] In the present case the form of instrument adopted by the taxpayer and the trustee amounted to a representation, apart from the statement in the prospectus, that the certificates were not taxable in Ohio. Yet if the claim of the taxpayer be accepted here, it knew at the time that facts existed which would change the transaction

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[12] Such an opinion could not have been rendered in good faith had the issuer known of facts which turned the transaction into a loan secured by a mortgage. *Kirtland* v. *Hotchkiss*, 100 U. S. 491; Ohio Gen. Code (Throckmorton, 1926) § 5325, *Pattrick* v. *Littell*, 36 Ohio St. 79 (1880).

[13] See also L. R. A. 1916 B, Sec. 107, p. 186.

into a loan secured by a mortgage and render the certificates taxable. No equity exists in favor of a grantor which has misled the other party in interest in such fashion. *Nitkey* v. *Ward*, 199 Minn. 334; *City Nat. Bank Bldg. Co.* v. *Helvering*, 98 F. (2d) 216, 222 (App. D. C.).[14] The situation presented here is similar to that which came before the Circuit Court of Appeals for the Second Circuit in *In re The Westover*, 82 F. (2d) 177. There an assignment of a mortgage, in form absolute, was claimed by the grantor to have been merely a pledge of the mortgage to secure a debt. Certain undivided shares in the mortgage, however, had been assigned by means of certificates sold to the public. The court there held that the certificates must be construed according to their terms and that the grantor was estopped from relying upon any undisclosed understanding with the grantee to the detriment of the certificate holders. In order to protect their tax immunity the certificate holders here, by parity of reasoning, could insist that the taxpayer be not regarded as a mortgagor. Since the taxpayer could not exercise the rights of a mortgagor clearly there exists no reasons for holding that it occupies such a position for the purposes of this tax controversy.

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[14] See *Hume* v. *Dixon*, 37 Ohio St. 66; *Wilson* v. *Hicks*, 40 Ohio St. 418; *Ensel* v. *Levy & Bro.*, 46 Ohio St. 253; *Standard Sanitary Mfg. Co.* v. *George*, 118 Ohio St. 564, 573; *Lomond Co.* v. *McNabb*, 109 W. Va. 142. See also 48 L. R. A. (n. s.) 745.

II

THE TAXPAYER HAS NO INVESTMENT IN THE DEPRECIABLE PROPERTY

Since the taxpayer must be regarded as a lessee and not as a mortgagor, the existence of a present separate investment in the depreciable property must be established as the basis for a depreciation allowance. *Weiss* v. *Wiener*, 279 U. S. 333; *Duffy* v. *Central R. Co. of New Jersey*, 268 U. S. 55.

The original investment of the taxpayer in the premises has been returned to it in the form of cash in excess of three million dollars and valuable rights acquired under the lease. It has made no additional investment in the premises since acquiring them as lessee. Accordingly, it has no investment in any particular property on the premises and cannot definitely establish that the wasting of a particular asset, for example a building, represents a current loss to it. *Weiss* v. *Wiener*, 279 U. S. 333.

The situation before this Court in *Weiss* v. *Wiener*, 279 U. S. 333, was in all essentials the same as that presented here. The taxpayer was the lessee under thirteen 99-year leases, renewable forever, upon real estate in Ohio. Several of the leases required the lessee to maintain on the premises buildings of a value not less than a stated amount, to keep the buildings in "like condition as the same now are in," and in case of their removal or destruction from any cause to replace them with new buildings of a value equal to or in

excess of the value of the existing buildings. The taxpayer sought an allowance for depreciation on the buildings which were conceded to have a useful life much shorter than the terms of the leases. *Wiener* v. *Weiss*, 27 F. (2d) 200. This Court pointed out (p. 336) that the capital of the lessee was not currently being consumed and concluded that it was not enough that the taxpayer might have to replace the capital at some future time. See *New York Central Railroad Co.* v. *Commissioner*, 79 F. (2d) 247 (C. C. A. 2d), certiorari denied, 296 U. S. 653; *Atlantic Coast Line R. Co.* v. *Commissioner*, 81 F. (2d) 309 (C. C. A. 4th), certiorari denied, 298 U. S. 656, 691.

The payments into the so-called depreciation fund provided in the lease in no way aid the taxpayer here. The fund draws interest and remains the property of the taxpayer, subject to the terms of the lease (R. 56–57, 58). It may never pass to the lessor as damages for the depreciation of the property. On the contrary, it will be credited to the taxpayer as part of the purchase price in the event it exercises its option to retake the property (R. 59–60). Taxpayer will likewise receive credit for the fund if it sells its rights under the lease. The retention of these incidents of ownership is inconsistent with a claim that taxpayer is incurring a present loss. Certainly the payments do not show the existence of a present depreciating investment in the buildings.

CONCLUSION

The taxpayer sold its premises to the trustee for the benefit of the land-trust certificate holders and now occupies the property as lessee. Accordingly, it has no depreciable interest in the buildings acquired from the lessor and occupied under the terms of the lease. The judgment of the Circuit Court of Appeals should, therefore, be reversed.

Respectfully submitted.

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